

# NEW APPLICATION



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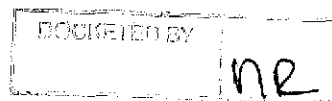
BEFORE THE ARIZONA CORPORATION COMMISSION

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Arizona Corporation Commission

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OCT -1 2008



T-03267A-09-0475

**COMMISSIONERS**

KRISTIN K. MAYES – Chairman

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PAUL NEWMAN

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BOB STUMP

2008 OCT -1 P 4: 00

ARIZONA CORPORATION COMMISSION  
DOCKET CONTROL

IN THE MATTER OF THE APPLICATION OF )  
MCLEODUSA TELECOMMUNICATIONS )  
SERVICES, INC. D/B/A PAETEC BUSINESS )  
SERVICES FOR A FINANCING ORDER )  
AUTHORIZING VARIOUS FINANCING )  
TRANSACTIONS )

DOCKET NO. \_\_\_\_\_

**APPLICATION FOR  
FINANCING ORDER  
(Expedited Approval Requested)**

**I. INTRODUCTION.**

McLeodUSA Telecommunications Services, Inc. d/b/a PAETEC Business Services (“PAETEC Business” or “Applicant”), by and through its undersigned counsel, hereby respectfully submits this Application for a Financing Order (“Application”) requesting that the Arizona Corporation Commission (“Commission”) authorize Applicant pursuant to A.R.S. § 40-285 and A.A.C. R14-2-804, and, to the extent necessary,<sup>1</sup> any other applicable statutes or rules, to participate in various financing arrangements contemplated by its ultimate corporate parent, as described more fully herein.

PAETEC Business is an Iowa corporation with principal offices located in Hiawatha, Iowa. In Arizona, Applicant provides resold and facilities-based telecommunications and exchange access services pursuant to Certificates of Convenience and Necessity granted in Decision Nos. 62627 and 61001. PAETEC Business is an indirect wholly owned subsidiary of PAETEC Holding Corp. (“PAETEC Parent”), a publicly traded Delaware corporation headquartered in Fairport, New

<sup>1</sup> Although Applicant is seeking any necessary approval for its participation in these financing arrangements, Applicant does so without prejudice to its right to assert that such transactions are beyond the jurisdiction of the state public utility commissions.

1 York. PAETEC Parent is one of the largest nationwide providers of competitive communications  
2 services, with a presence in 83 of the nation's top 100 metropolitan statistical areas ("MSAs").

3 PAETEC Parent anticipates that over the next five years it will enter into various financing  
4 arrangements including, but not limited to, transactions to amend, restate, and/or refinance long-  
5 term debt, finance new capital expenditures, and obtain funding for general corporate purposes and  
6 working capital. In order for PAETEC Parent to capture market conditions favorable to such  
7 arrangements, PAETEC Business needs the flexibility to immediately participate in such financing  
8 transactions before such conditions change and the opportunity to take advantage of favorable  
9 financing conditions and other business opportunities is lost. Accordingly, PAETEC Business  
10 requests an order providing it with the flexibility to participate in various financing transactions  
11 and related arrangements as follows:

12 1. Authorization under A.R.S. §40-285 to encumber its Arizona assets as security for  
13 up to \$700 million in additional long-term indebtedness of PAETEC Parent (and, as applicable, its  
14 subsidiaries, including Applicant). The requested authorization is in addition to the approval  
15 already granted by the Commission in Decision No. 70126;<sup>2</sup>

16 2. Authorization under A.A.C. R14-2-804 to guarantee the obligations of PAETEC  
17 Parent (and, as applicable, its other subsidiaries) for up to \$700 million in additional long-term  
18 indebtedness. The requested authorization, which would cover the execution and delivery of one  
19 or more guarantees, pledge and security agreements, and such other agreements as may be  
20 required, is in addition to the approval separately obtained in Decision No. 70126; and

21 3. Authorization to participate in various financing arrangements related to any  
22 restructuring, refinancing and/or financing of any long-term indebtedness of PAETEC Parent (and,  
23 as applicable, its subsidiaries, including Applicant) covered by the authorization granted in  
24 paragraphs 1 and 2 immediately preceding and by Decision No. 70126, so long as the total long-  
25 term indebtedness at any one time outstanding complies with such conditions as the Commission

26 \_\_\_\_\_  
27 <sup>2</sup> A copy of Decision No. 70126 is attached hereto as Exhibit A.

determines are necessary to include in its order approving this Application ("Financing Order"). The authorization to participate in such related financing arrangements shall permit refinancings, refundings, renewals, reissuances, redemptions, and rollovers of any such indebtedness outstanding, the incurrence or issuance of additional long-term indebtedness, and the amendment or revision of any terms or provisions of, or relating to, any long-term indebtedness.

The authority described above will provide PAETEC Parent with the flexibility required to access the capital markets in a timely and efficient manner, to take advantage of opportunities to reduce its financing costs, obtain more attractive terms and conditions and/or relaxed covenant restrictions, better leverage its financial resources, and select the financing options most appropriate for the purpose of the debt. PAETEC Business submits that Commission approval of this Application will enable PAETEC Parent to strengthen its financial condition, which will enhance PAETEC Business's competitive position in the Arizona telecommunications marketplace, and ultimately inure to the benefit of Arizona customers. Granting of this Application therefore will serve the public interest of the State of Arizona.

In support of this Application, Applicant states as follows:

## II. DESCRIPTION OF THE PARTIES.

### A. McLeodUSA Telecommunications Services, Inc. d/b/a PAETEC Business Services.

PAETEC Business is an Iowa corporation with principal offices located at One Martha's Way, Hiawatha, Iowa 52233. PAETEC Business is an indirect wholly owned subsidiary of PAETEC Parent. PAETEC Business provides integrated communications services, including local services, primarily in 20 Midwest, Southwest, Northwest, and Rocky Mountain states.<sup>3</sup> In Arizona, PAETEC Business is authorized to provide resold and facilities-based local exchange and

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<sup>3</sup> PAETEC Business is authorized to provide resold and/or facilities-based telecommunications services in 48 states and the District of Columbia pursuant to certification, registration or tariff requirements, or on a deregulated basis. Additionally, PAETEC Business is authorized by the Federal Communications Commission to provide international and domestic interstate telecommunications services as a nondominant carrier and fixed, broadband point-to-multipoint wireless service.

1 exchange access services pursuant to Decision No. 62627, granted on June 9, 2000. PAETEC  
2 Business is also authorized to resold interexchange telecommunications services pursuant to  
3 Decision No. 61001, granted on July 16, 1998. As shown on its 2008 Annual Report filed with the  
4 Commission, Applicant generated more than \$1 million of Arizona jurisdictional revenue.  
5 Applicant therefore is a Class A utility subject to the Commission's Public Utility Holding  
6 Companies and Affiliated Interest Rules, A.A.C. R14-801 *et seq.*

7 **B. PAETEC Holding Corp.**

8 PAETEC Parent<sup>4</sup> is a publicly traded Delaware corporation (NASDAQ GS: PAET) with  
9 principal offices located at One PAETEC Plaza, 600 Willow Brook Office Park, Fairport, New  
10 York 14450. Through its regulated operating subsidiaries, PAETEC Parent has a presence in 83 of  
11 the nation's top 100 MSAs, delivering communications solutions to business customers in 48  
12 states and the District of Columbia. In Arizona, PAETEC Parent provides regulated  
13 communications services through three wholly owned subsidiaries: PAETEC Business, PAETEC  
14 Communications, Inc. ("PCI")<sup>5</sup> and US LEC Communications Inc. ("US LEC").<sup>6</sup> Additional  
15 information regarding PAETEC Parent, including its most recent SEC Form 10-Q, as filed with  
16 the Securities and Exchange Commission, is available at [www.paetec.com](http://www.paetec.com).

17 **C. Designated Contacts.**

18 Questions, correspondence or other communications concerning this Application should be  
19 directed to:  
20

21 <sup>4</sup> As used in this Application, "PAETEC Parent" refers to PAETEC Holding Corp. and, where applicable,  
22 its predecessor, PAETEC Corp.

23 <sup>5</sup> PCI is authorized to provide resold intrastate interexchange services in Arizona pursuant to a Certificate of  
24 Convenience and Necessity ("Certificate") granted in Decision No. 62458. PCI does not join in this  
25 Application because it has no physical presence in Arizona and, moreover, is not a Class A investor-owned  
26 utility subject to A.A.C. R14-2-804.

27 <sup>6</sup> US LEC is authorized to provide resold intrastate interexchange services in Arizona pursuant to a Certificate  
granted in Decision No. 66740. Like PCI, US LEC does not join in this Application because it has no  
physical presence in Arizona and is not a Class A investor-owned utility subject to A.A.C. R14-2-804. US  
LEC, moreover, ceased operations in Arizona in 2007 and has pending before the Commission an application  
for approval to surrender its Certificate. *Application of US LEC Communications, Inc. for Approval to  
Relinquish Certificate of Convenience and Necessity to Provide Resold Interexchange Services In the State of  
Arizona and to Cancel Tariff*, Docket No. T-04194A-07-0624 (filed Oct. 30, 2007).

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with a copy to the following designated representative of Applicant:

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Hiawatha, Iowa 52233  
Email: William.Haas@paetec.com

**III. PETITIONERS' PARTICIPATION IN PAETEC PARENT'S EXISTING LONG-TERM INDEBTEDNESS OF PAETEC PARENT.**

By Decision No. 70126, issued on January 23, 2008, the Commission authorized Applicant, subject to certain conditions, to participate in certain debt financing arrangements of PAETEC Parent upon consummation of the proposed merger of PAETEC Parent with Applicant's (then) ultimate corporate parent, McLeodUSA Incorporated.<sup>7</sup> A copy of Decision No. 70126 is attached hereto as Exhibit A.

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<sup>7</sup> The merger was consummated on February 8, 2008.

Decision No. 70126 authorized a total of \$1.35 billion in aggregate principal amount of all indebtedness. Specifically, the Commission approved Applicant's request for authorization to guarantee and secure the obligations of PAETEC Parent, as borrower, under Senior Secured Credit Facilities of \$550 million aggregate principal amount (the "Credit Facilities")<sup>8</sup> and to guarantee the obligations of PAETEC Parent as issuer of \$300 million aggregate principal amount of its 9.5% Senior Notes due 2015 ("Senior Notes"). The Commission also authorized Applicant to incur, guarantee and/or secure additional indebtedness of up to \$500 million in the form of incremental term loans and additional notes, which additional indebtedness is permitted under the credit facility agreement and the indenture governing the Senior Notes.

On June 29, 2009, in a private offering exempt from the registration requirements of the Securities Act of 1933, PAETEC Parent issued approximately \$350 million aggregate principal amount of its 8.875% Senior Secured Notes due 2017 ("Senior Secured Notes"). The debt obligations of PAETEC Parent under the Senior Secured Notes were secured by the existing security and pledge agreements and the existing guarantee, each as previously executed by PAETEC Business pursuant to the authorization granted in Decision No. 70126.

PAETEC Parent applied the proceeds of the June 29, 2009 senior notes offering, together with cash on hand, to repay approximately \$330.5 million principal amount of outstanding term loans under the Credit Facilities. Following the repayment, the debt obligations of PAETEC Parent currently total approximately \$941 million in aggregate principal amount. More specifically, PAETEC Parent's indebtedness currently consists of: (1) a term loan of approximately \$241 million aggregate principal amount and a revolving loan of \$50 million aggregate principal amount, both outstanding under the Credit Facilities; (2) \$300 million aggregate principal amount of its Senior Notes; and (3) \$350 million aggregate principal amount of its Senior Secured Notes.

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<sup>8</sup> At the time of the filing of the application, the Credit Facilities consisted of a \$498 term loan facility, all of which was fully drawn, and a \$50 million revolving facility, none of which was drawn.

1 Although Decision No. 70126 authorized PAETEC Business to incur, guarantee and/or  
2 secure up to \$500 million in additional indebtedness, PAETEC Parent issued only \$350 million  
3 aggregate principal amount of its Senior Secured Notes. Because PAETEC Parent did not incur  
4 debt obligations for the full amount authorized by Decision No. 70126, PAETEC Business has  
5 authorization to incur, guarantee and/or secure up to \$150 million in additional indebtedness  
6 ("Unused Debt Capacity").

7 **IV. REQUEST FOR APPROVAL TO PARTICIPATE IN VARIOUS DEBT**  
8 **FINANCING ARRANGEMENTS.**

9 **A. Purposes of Financing Transactions.**

10 PAETEC Parent anticipates that over the next five years it will enter into various financing  
11 *transactions for the following purposes: to refinance existing long-term debt obligations with*  
12 *lower cost debt instruments; to refinance existing long-term debt maturities; to finance new capital*  
13 *expenditures supporting both the expansion of its national footprint, including the acquisition of*  
14 *other telecommunications companies and/or telecommunications assets, and the enhancement of*  
15 *its communications service offerings; and to provide for working capital and other general*  
16 *corporate purposes.*

17 **B. Request for Prior Approval to Participate in Such Financing Transactions.**

18 In connection with such financing transactions, it is expected that PAETEC Business  
19 (together with certain other PAETEC Parent subsidiaries) will be required to guarantee and secure  
20 the debt obligations of PAETEC Parent (or other subsidiaries of PAETEC Holding incurring debt  
21 pursuant to such transactions) by encumbering its assets and executing and delivering one or more  
22 guarantees, pledge agreements, and such other security agreements as may be required in a given  
23 transaction.

24 In anticipation of these transactions and recognizing the need to expeditiously capture  
25 favorable market conditions as may occur from time to time, PAETEC Business hereby requests  
26  
27

1 the Commission to issue a Financing Order authorizing PAETEC Business to participate in such  
2 financing transactions and related arrangements as follows:

3 1. Authorization under A.R.S. §40-285 to encumber its Arizona assets as security for  
4 up to \$700 million of additional long-term indebtedness of PAETEC Parent (and, as applicable, its  
5 subsidiaries, including Applicant). The authorization to encumber assets to secure any such long-  
6 term indebtedness is in addition to the approval already granted by the Commission in Decision  
7 No. 70126;<sup>9</sup>

8 2. Authorization under A.A.C. R14-2-804 to provide security in the form of  
9 guarantees, pledge and security agreements, and such other agreements as may be required in  
10 connection with any additional long-term indebtedness of PAETEC Parent (and, as applicable, its  
11 other subsidiaries) of up to \$700 million. The authorization to provide such forms of security for  
12 any such long-term indebtedness is in addition to the approval already granted by the Commission  
13 in Decision No. 70126;<sup>10</sup> and

14 3. Authorization to participate in various financing arrangements related to any  
15 restructuring, refinancing and/or financing of any long-term indebtedness of PAETEC Parent (and,  
16 as applicable, its subsidiaries, including Applicant) covered by the authorization granted in  
17 paragraphs 1 and 2 immediately preceding and by Decision No. 70126, so long as the total long-  
18 term indebtedness at any one time outstanding complies with such conditions as the Commission  
19 determines are necessary to include in its order approving this Application. The authorization to  
20 participate in such related financing arrangements shall permit refinancings, refundings, renewals,  
21 reissuance, redemptions, and rollovers of any such indebtedness outstanding, the incurrence or  
22

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23 <sup>9</sup> Pursuant to Decision No. 70126, PAETEC Business encumbered its Arizona assets to secure the  
24 indebtedness outstanding under PAETEC Parent's existing debt financing arrangements, approximately  
25 \$941 million of which is outstanding under PAETEC Parent's existing debt financing arrangements.  
Pursuant to the Unused Debt Capacity under Decision No. 70126, PAETEC Business is authorized to grant  
a security interest in its Arizona assets to secure up to \$150 million in additional indebtedness.

26 <sup>10</sup> Pursuant to Decision No. 70126, PAETEC Business guaranteed the obligations of PAETEC Parent,  
approximately \$941 million of which is outstanding under PAETEC Parent's existing debt financing  
27 arrangements. Pursuant to the Unused Debt Capacity under Decision No. 70126, PAETEC Business is  
authorized to guarantee up to \$150 million in additional indebtedness.



1 issuance of additional long-term indebtedness, and the amendment or revision of any terms or  
2 provisions of, or relating to, any existing long-term indebtedness.

3 **C. Expected Core Terms of Future Financing Arrangements.**

4 The exact amounts and terms of each financing transaction or related arrangement, which  
5 may be completed in multiple tranches, will not be finalized until the specific arrangement(s) have  
6 been completed or shortly before funding of the various transactions, and will reflect market  
7 conditions then existing. Some of the terms, such as the interest rate, may fluctuate during the  
8 term of the financing due to changes in market condition and the financial condition of PAETEC  
9 Parent. The core terms of each such financing arrangement are expected to be substantially as  
10 follows:

11 ***Funding Providers:*** The funding providers may be banks, financial institutions, private  
12 lending institutions, private individuals, and/or other institutions, either individually or a  
13 consortium. The funding group may change over the life of the financing.

14 ***Amount:*** Up to \$700 million.

15 ***Debt instruments.*** Portions of the financed funds may be in the form of conventional  
16 credit facilities, such as revolving credits (which can be reborrowed during the term of the  
17 commitment); letters of credit; secured or unsecured notes or debentures (including notes  
18 convertible into common stock) issued to banks, other types of financial institutions or other  
19 investors; and term loans.

20 ***Maturity:*** Any maturity date will be subject to negotiation and will depend on credit  
21 conditions. All maturity dates will be longer than one (1) year.

22 ***Interest:*** Any interest rate will likely be the market rate for similar financings and will not  
23 be determined until the financing is finalized. As is typical in such transactions, the interest rate  
24 will have two components: a base rate and a margin rate. The base rate would be defined as the  
25 base or prime rate charged by a specified major bank for loans of similar size with similar  
26 maturities or as an adjusted federal funds rate. Eurodollar loans would be specified on a specified  
27 London Interbank Rate (LIBOR).

1       **Security:** Relevant to this Application, some and perhaps all of the loans to PAETEC  
2 Parent are expected to be secured by a security interest in substantially all of PAETEC Business's  
3 assets. The stock of PAETEC Business may also be pledged as additional security. Additionally,  
4 it is expected that PAETEC Business will provide guarantees or may be a borrower or co-  
5 borrower. The security documents will contain appropriate provisions indicating that exercise of  
6 certain rights thereunder may be subject to obtaining prior regulatory approval.

7       **Use of Proceeds:** As noted above, proceeds will be available to refinance existing long-  
8 term debt obligations with lower cost debt instruments; refinance existing long-term debt  
9 maturities; finance new capital expenditures; and for working capital and other general corporate  
10 purposes. Additionally, proceeds of any such transactions may be used to pay fees and expenses  
11 incurred in connection with such arrangements.

12       The proposed financings are purely financial in nature and will not alter the rates, terms,  
13 conditions or services offered by PAETEC Business in Arizona. PAETEC Business will remain a  
14 wholly owned subsidiary of PAETEC Parent and will continue to operate as a provider of  
15 telecommunications services in Arizona.

16       **V. PUBLIC INTEREST CONSIDERATIONS.**

17       Granting of this Application will serve the public interest of the State of Arizona because  
18 the authorization requested will enable PAETEC Parent to capture favorable market conditions in  
19 a timely and efficient manner and thereby take advantage of opportunities to reduce its financing  
20 costs, obtain more attractive terms and conditions and relaxed covenant restrictions, better  
21 leverage its financial resources, and select the financing options most appropriate for the purpose  
22 of the debt. The flexibility afforded by the authorization requested herein will enable PAETEC  
23 Parent to strengthen its financial condition and, in turn, create opportunities to enhance the  
24 respective competitive position of its Arizona operating subsidiaries, including PAETEC Business,  
25 in the Arizona telecommunications marketplace, all of which ultimately will inure to the benefit of  
26 their respective Arizona customers.  
27

1 Grant of this Application is particularly important to PAETEC Business in light of the U.S.  
2 economic crisis, which is reflected in the continued turbulence in financial markets worldwide.  
3 The wave of U.S. bank failures coupled with the freeze in credit markets has led PAETEC Parent  
4 to consider fresh approaches to navigating the altered landscape of the financial markets. Whereas  
5 prior to the economic crisis, PAETEC Parent was able to monitor and take advantage of favorable  
6 market conditions that presented windows of opportunity that remained open for extended periods  
7 of time, the current economic climate and market instability require PAETEC Parent to have the  
8 ability to move quickly to take advantage of favorable financing opportunities before they  
9 disappear.

10 The ability to move quickly depends in large measure on the length of time required to  
11 obtain regulatory approval. Whereas in the past, PAETEC Business has generally had adequate  
12 time to obtain prior regulatory approval to participate in financing arrangements, PAETEC Parent  
13 believes it can no longer seize such favorable opportunities if applications for regulatory approval  
14 must contain all of the key terms of the financing arrangement being contemplated. Faced with the  
15 continued economic uncertainty reflected the financial markets, PAETEC Parent must have both  
16 the ability to respond immediately to capture favorable market conditions and the flexibility to  
17 enter into different types of debt financing arrangements.<sup>11</sup> For this reason, PAETEC Business  
18 submits the instant Application for prior approval of the anticipated financing arrangements before  
19 negotiations of these arrangements, including key terms and conditions, have been concluded.  
20 PAETEC Business therefore has supplied the core terms expected of these arrangements and  
21 explained the purposes for which the proceeds may be used. This approach strikes the proper  
22 balance between complying with the statutory requirement to obtain such approval of an  
23 encumbrance and the practical reality that certain terms and conditions will be determined when  
24

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25 <sup>11</sup> The decision as to whether to pursue any given opportunity will be made by PAETEC  
26 depending on a combination of factors, such as PAETEC's recent quarterly results, its short- and long-term  
27 needs, and the anticipated length of time that the "window" to capture favorable market conditions will be open.

1 negotiation of the arrangement has been completed (which is expected to occur shortly before the  
2 transaction closes).

3 If PAETEC Business cannot use this approach, PAETEC Parent may be forced to forgo  
4 financial opportunities that could reap the company substantial savings and other economic  
5 benefits. In turn, the benefits that would flow to the Arizona operating subsidiaries, including  
6 PAETEC Business, from PAETEC Parent's strengthened financial position would be lost, along  
7 with potential service benefits and enhancements that would inure to their Arizona customers. The  
8 authorization sought in this Application is similar to that which the Commission granted in  
9 Decision Nos. 70126, 69946 and 69247. Granting of this Application will similarly serve the  
10 public interest of the State of Arizona.

11 Finally, granting of this Application would not be contrary to the public interest because no  
12 transfer of PAETEC Business's Certificate, assets or customers will occur as a result of PAETEC  
13 Business's participation in any debt financing transaction. Immediately following PAETEC  
14 Business's execution of the relevant documents in connection with such debt financing  
15 arrangements, PAETEC Business will continue to provide service to its Arizona customers  
16 pursuant to its existing Certificate with no change in the rates or terms and conditions of service as  
17 currently provided. These arrangements, moreover, will not affect the \$600,000 performance bond  
18 posted by PAETEC Business and currently in place, the purpose of which is to protect those  
19 Arizona customers whose have prepaid for service or given PAETEC Business deposits. PAETEC  
20 Business's participation in such debt financing arrangements will therefore be transparent to its  
21 Arizona customers.

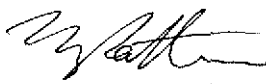
22 **VI. CONCLUSION.**

23 For foregoing reasons, PAETEC Business submits that the public interest, convenience,  
24 and necessity would be furthered by grant of this Application and issuance of a financing order  
25 authorizing Applicant to participate in the various financing transactions and related arrangements  
26 as described herein. PAETEC Business further respectfully requests expedited consideration and  
27 approval of this Application without hearing.

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TELEPHONE NO 602-256-6100  
FACSIMILE 602-256-6800

RESPECTFULLY SUBMITTED this 1<sup>st</sup> day of October 2009.

ROSHKA DEWULF & PATTEN, PLC

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Of Counsel

Attorneys for McLEODUSA Telecommunications Services,  
Inc. dba PAETEC Business Services

Original and 13 copies of the foregoing  
filed this 1<sup>st</sup> day of October 2009 with:

Docket Control  
Arizona Corporation Commission  
1200 West Washington Street  
Phoenix, Arizona 85007

Copy of the foregoing hand-delivered/mailed  
this 1<sup>st</sup> day of October 2009 to:

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Arizona Corporation Commission  
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Janice Alward, Esq.  
Chief Counsel, Legal Division  
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1200 West Washington  
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1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 **MIKE GLEASON**  
Chairman  
3 **WILLIAM A. MUNDELL**  
Commissioner  
4 **JEFF HATCH-MILLER**  
Commissioner  
5 **KRISTIN K. MAYES**  
Commissioner  
6 **GARY PIERCE**  
Commissioner

Arizona Corporation Commission<sup>1</sup>

**DOCKETED**

JAN 23 2008

DOCKETED

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8 IN THE MATTER OF THE APPLICATION ) DOCKET NO. T-03267A-07-0554  
OF PAETEC HOLDING CORP., )  
9 MCLEODUSA INCORPORATED AND ) DECISION NO. 70126  
MCLEODUSA TELECOMMUNICATIONS )  
10 SERVICES, INC. FOR APPROVAL TO ) ORDER  
11 TRANSFER INDIRECT CONTROL OF )  
MCLEODUSA TELECOMMUNICATIONS )  
12 SERVICES, INC. AND FOR MCLEODUSA )  
TELECOMMUNICATIONS SERVICES, )  
13 INC. TO PARTICIPATE IN CERTAIN )  
14 DEBT FINANCING ARRANGEMENTS )

15 Open Meeting  
16 January 15 and 16, 2008  
Phoenix, Arizona

17 BY THE COMMISSION:

18 FINDINGS OF FACT

19 INTRODUCTION

20 On September 27, 2007, PAETEC Holding Corp. ("PAETEC") and McLeodUSA  
21 Incorporated ("McLeodUSA Parent") filed an Application requesting expedited approval under  
22 A.R.S. § 40-285 and A.A.C. R14-2-803 and R14-2-804.B.1, to the extent necessary, as well as any  
23 other applicable statutes or rules, for the transfer of indirect control of McLeodUSA  
24 Telecommunications Services, Inc. ("McLeodUSA") from McLeodUSA Parent to PAETEC and  
25 for McLeodUSA to participate in PAETEC's debt financing arrangements. Additionally, the  
26 Applicants requested approval to issue guarantee and to pledge or encumber assets.

27 The transfer of control will result from PAETEC's proposed acquisition of McLeodUSA  
28 Parent through the merger of McLeodUSA Parent with a newly formed subsidiary of PAETEC  
("PS Acquisition Corp."). Following the merger, McLeodUSA Incorporated will be the surviving

entity. No transfer of certificate, assets, or customers will occur as a result of the transfer of control or McLeodUSA's participation in the debt financing. McLeodUSA will continue to provide service to its Arizona customers under its existing certificate with no change in the rates, terms, or conditions of service as currently provided.

#### THE PARTIES

McLeodUSA Parent and PAETEC in their Application and through data responses represent the following:

1. McLeodUSA is a corporation organized under the laws of Iowa with a principal place of business located at One Martha's Way, Hiawatha, Iowa 52233. McLeodUSA currently provides telecommunications services in 48 States. McLeodUSA offers local service in the following 25 States:

|          |           |           |              |              |            |
|----------|-----------|-----------|--------------|--------------|------------|
| Arizona  | Indiana   | Michigan  | Nebraska     | Oklahoma     | Utah       |
| Arkansas | Iowa      | Minnesota | New Mexico   | Oregon       | Washington |
| Colorado | Kansas    | Missouri  | North Dakota | South Dakota | Wisconsin  |
| Idaho    | Louisiana | Montana   | Ohio         | Texas        | Wyoming    |
| Illinois |           |           |              |              |            |

2. In Arizona, McLeodUSA is authorized to provide resold and facilities-based local exchange and exchange access telecommunications services pursuant to Decision No. 62627, granted June 9, 2000. McLeodUSA is also authorized to provide resold interexchange telecommunications services pursuant to Decision No. 61001, granted July 16, 1998.

3. McLeodUSA is a wholly-owned subsidiary of McLeodUSA Holdings, Inc, which is a wholly-owned subsidiary of McLeodUSA Parent. McLeodUSA currently provides service to approximately 3,142 business and residential customers in the State of Arizona. McLeodUSA and the other Arizona affiliates<sup>1</sup> of McLeodUSA Parent employ approximately 18 people in Arizona.

4. McLeodUSA Parent is a privately-held Iowa company headquartered in Cedar Rapids, Iowa. Through its operating subsidiaries, McLeodUSA Parent currently owns and operates a high-capacity fiber network that spans 20 Midwest, Southwest, Northwest, and Rocky

<sup>1</sup> The additional Arizona affiliates of McLeodUSA Parent include: McLeodUSA Information Services, Inc., McLeodUSA Network Services, Inc., and McLeodUSA Purchasing, LLC.



Mountain States. The fiber network contains approximately 13,000 intercity route miles and approximately 4,000 metro route miles. McLeodUSA Parent provides telecommunications services primarily to small and medium-sized enterprise and multi-location commercial customers.

5. PAETEC is a publicly traded corporation under the laws of Delaware with a principal place of business located at One PAETEC Plaza, 600 Willowbrook Office Park, Fairport, New York 14450. Through its operating subsidiaries, PAETEC currently provides telecommunications services to more than 45,000 medium and large business customers in major metropolitan areas in 24 states. Collectively, the 12 wholly-owned subsidiaries operate in 48 States and the District of Columbia. PAETEC is currently certified to provide local service in the following 35 States listed below, plus the District of Columbia;

|             |           |               |                |                |           |
|-------------|-----------|---------------|----------------|----------------|-----------|
| Alabama     | Georgia   | Maryland      | Nevada         | Ohio           | Texas     |
| California  | Illinois  | Massachusetts | New Hampshire  | Oregon         | Utah      |
| Colorado    | Indiana   | Michigan      | New Jersey     | Pennsylvania   | Vermont   |
| Connecticut | Kansas    | Minnesota     | New Mexico     | Rhode Island   | Virginia  |
| Delaware    | Kentucky  | Mississippi   | New York       | South Carolina | Wisconsin |
| Florida     | Louisiana | Missouri      | North Carolina | Tennessee      |           |

6. In Arizona, PAETEC's two subsidiaries, PAETEC Communications, Inc. ("PCI") and US LEC Communications, Inc. ("US LEC"), are authorized to provide resold intrastate interexchange telecommunications services. PCI is authorized to provide service pursuant to Decision No. 62458 granted, April 14, 2000, and US LEC is authorized to provide service by Decision No. 66740, granted January 20, 2004.

7. PAETEC intends to voluntarily surrender the US LEC Certificate of Convenience and Necessity ("CC&N") and has filed a separate Application for Commission approval under Docket No. T-04194A-07-0624.

8. As of October 31, 2007, PAETEC and its Arizona affiliates are serving 282 customers in the State of Arizona. This number primarily represents business customers but does include some residential customers. PAETEC currently has no Arizona employees.

...

1           9.     PAETEC currently serves major Metropolitan Statistical Areas ("MSA") in 24  
2 States and employs approximately 2,300 people. PAETEC is headquartered in Rochester, New  
3 York, with major operations centers in Charlotte, North Carolina; Mt. Laurel, New Jersey; and  
4 Irvine, California. PAETEC has been operating as a competitive communications provider for  
5 nearly a decade and presently has more than 2.65 million access line equivalents in service as of  
6 June 30, 2007.

7 THE TRANSACTION

8           McLeodUSA Parent and PAETEC in their Application represent the following:

9           10.    PAETEC and McLeodUSA Parent entered into an Agreement and Plan of Merger  
10 dated September 17, 2007.

11           11.    The Agreement provides for a business combination, or merger, of PAETEC and  
12 McLeodUSA Parent by which PAETEC will acquire McLeodUSA Parent in an all-stock merger  
13 and McLeodUSA Parent will be merged into a wholly-owned subsidiary of PAETEC.

14           12.    The PAETEC entity into which McLeodUSA Parent will be merged is a newly  
15 formed entity named PS Acquisition Corp., which was created for the specific purpose of this  
16 transaction.

17           13.    McLeodUSA will be the surviving entity of the merger and will be an indirect,  
18 wholly-owned subsidiary of PAETEC.

19           14.    Although the transaction will result in a change in the ownership and control of  
20 McLeodUSA, no transfer of certificate, assets, or customers will occur as a result of the transfer of  
21 control or McLeodUSA's participation in the debt financing.

22           15.    McLeodUSA will continue to provide service to its Arizona customers pursuant to  
23 its existing certificate and customers will continue to receive service under the same rates, terms,  
24 and conditions of service. The transfer of control and McLeodUSA's participation in the debt  
25 financing will be transparent to the customers of McLeodUSA.

26           16.    PAETEC will acquire McLeodUSA Parent in an all-stock merger for approximately  
27 \$557 million. The merger price consists of approximately \$492 million in PAETEC common  
28 stock and approximately \$65 million in net debt assumption.

1           17.     Current McLeodUSA Parent shareholders will receive 1.30 shares of PAETEC  
2 common stock for every share of McLeodUSA Parent common stock that they own.

3           18.     PAETEC will continue to be headquartered in Fairport, New York, and will  
4 maintain McLeodUSA Parent's operations in Cedar Rapids, Iowa, and other regional centers,  
5 including Tulsa, Oklahoma. After closing of the transaction, PAETEC's current board of directors  
6 will add one director to be designated by certain principal stockholders of McLeodUSA Parent.

7           19.     Under the proposed transaction, McLeodUSA will guarantee the obligations of  
8 PAETEC, as borrower, under the senior secured credit facilities aggregate principal amount of  
9 \$550 million and grant a security interest in all of its assets to secure all amounts owing under the  
10 credit facilities. PAETEC has a \$498 million term loan facility<sup>2</sup> and a \$50 million revolving credit  
11 facility with final maturity dates of February 28, 2013 and February 28, 2012, respectively. Any  
12 proceeds under the revolving credit facility will be used for working capital, capital expenditures,  
13 and other general corporate purposes. Under the terms of the Credit Agreement, each direct and  
14 indirect, current and future subsidiary of PAETEC is required to provide an unconditional  
15 guarantee of all amounts owing under the credit facilities and to grant a security interest in all of its  
16 assets to secure all amounts owing under the credit facilities.

17           20.     McLeodUSA will also guarantee the obligations of PAETEC under the \$300  
18 million aggregate principal amount of PAETEC's 9.5% Senior Notes due in 2015.<sup>3</sup> Subject to  
19 receipt of required governmental approvals, each of PAETEC's current and future wholly-owned  
20 subsidiaries is required to guarantee the Notes on a senior unsecured basis. There is no obligation  
21 for any subsidiary to guarantee the Notes until after such subsidiary obtains such required  
22 governmental approvals.

23           21.     In addition, McLeodUSA intends to incur, guarantee and/or secure additional  
24 borrowings up to a total of \$500 million of additional indebtedness in the form of incremental term

25  
26 <sup>2</sup> Under the term loan facility, borrowings were used to refinance substantially all of the senior secured indebtedness of  
27 PAETEC Corp. (the predecessor of PAETEC) and to repurchase all outstanding shares of the US LEC Corp. preferred  
28 stock in connection with the closing of the merger of PAETEC Corp. and US LEC Corp., in addition to paying the fees  
and expenses incurred in connection with the refinancing and stock repurchase.

<sup>3</sup> The net proceeds of the notes offering, along with cash on hand was used to repay \$300 million principal amount of  
term loans outstanding under the credit facilities. As a result of the partial term loan repayment, the current credit  
facilities consist of the \$498 million term loan and the \$50 million revolving credit facility.

1 loans and additional notes, which are permitted under the credit agreement governing the credit  
2 facilities and under the indenture that governs the terms of the Notes. Any such increased  
3 borrowings may be used for capital expenditures, and general corporate and working capital  
4 purposes.

5 22. The requested encumbrance of McLeodUSA's assets and related guaranty will  
6 replace McLeodUSA's existing encumbrance and guaranty approved by the Commission on  
7 February 20, 2007 in Decision No. 69346.

8 23. McLeodUSA's existing \$600,000 performance bond, which was obtained as a  
9 requirement of Decision No. 64657, will continue to remain in place.

#### 10 THE APPLICANTS REQUEST

11 McLeodUSA Parent, and PAETEC in their Application request that the Commission  
12 approve the following:

- 13 a. The transfer of indirect control of McLeodUSA resulting from the proposed merger  
14 pursuant to A.A.C. R14-2-803; and
- 15 b. McLeodUSA's participation in the debt financing arrangements pursuant to A.R.S.  
16 40-285 and A.A.C. R14-2-804.

17 The Applicants also request expedited consideration and approval of this Application  
18 without hearing no later than January 1, 2008.

#### 18 STAFF'S ANALYSIS

##### 19 The Affiliated Interests Rules

20 24. The Public Utility Holding Companies and Affiliated Interests Rules apply to all  
21 Class A – investor-owned utilities, defined as telecommunications carriers that have Arizona  
22 jurisdictional annual revenues of more than \$1 million. In the 2006 Annual Report filed with the  
23 Commission, McLeodUSA generated more than \$1 million of Arizona jurisdictional revenue. The  
24 proposed merger of PAETEC and McLeodUSA Parent will create an entity that is considered a  
25 Class A investor-owned utility. As a result, the Application is subject to A.A.C. R14-2-801  
26 through 805 of the Public Utility Holding Companies and Affiliated Interests Rules.

27 25. In its Application and in response to additional requests by Staff, the Applicants  
28 provided the following information as required by A.A.C. R14-2-803 (A):

- 1 a. The names and business addresses of the proposed officers and directors of the  
2 holding company;

3 Information concerning PAETEC's directors and officers has been provided  
4 as an attachment to the Application. Both PAETEC's and McLeodUSA's  
5 business addresses have also been provided in the Application.

- 6 b. The business purposes for establishing or reorganizing the holding company;

7 The proposed merger will offer business customers an alternative to legacy  
8 carriers through the combined footprint of the Applicants, along with a  
9 comprehensive suite of business services, and an extensive switching and  
10 fiber network. In addition, the merger should position PAETEC to realize  
11 substantial cost savings and achieve synergies to enhance their service  
12 offerings and provide more advanced telecommunications services to a  
13 broader customer base. The combined managerial and operational expertise  
14 of both PAETEC and McLeodUSA Parent will strengthen the competitive  
15 position of both companies whereby benefiting Arizona consumers and the  
16 telecommunications marketplace within the State of Arizona.

- 17 c. The proposed method of financing the holding company and the resultant capital  
18 structure;

19 As described in the Application, PAETEC is a publicly traded company  
20 with an established capital structure and significant financial resources. The  
21 methods it uses for financing will not change as a result of this transaction.  
22 A newly created subsidiary of PAETEC will merge with McLeodUSA  
23 Parent, with McLeodUSA surviving. PAETEC will issue additional equity  
24 in the company in connection with this transaction, but this will not  
25 materially impact how the company is financed.

- 26 d. The resultant effect on the capital structure of the public utility;

27 The Applicants have indicated that as a result of the merger, PAETEC will  
28 become the new parent of McLeodUSA. The capital structure of the

1 Arizona operating subsidiaries of both PAETEC and McLeodUSA Parent  
2 will be unaffected by the merger.

- 3 e. An organization chart of the holding company that identifies all affiliates and their  
4 relationships within the holding company;

5 The Applicants have provided both pre-merger and post-merger  
6 organization charts as an attachment to the Application.

- 7 f. The proposed method for allocating federal and state income taxes to the  
8 subsidiaries of the holding company;

9 The Applicants have stated that Federal and State income tax allocations  
10 among PAETEC and its subsidiaries are consistent with the provisions of  
11 Treasury Regulation Sections 1.1552-1(a). PAETEC's approach to  
12 allocating tax liability will not change materially as a result of this  
13 transaction.

- 14 g. The anticipated changes in the utility's cost of service and the cost of capital  
15 attributable to the reorganizations;

16 The merger is not expected to have any adverse impact on the cost of  
17 services provided by McLeodUSA and the PAETEC operating subsidiary.

18 The merger should improve all of the operating subsidiaries' access to  
19 capital at favorable rates through their common parent, PAETEC.

- 20 h. A description of diversification plans of affiliates of the holding company; and

21 The Applicants have no current plans for diversification or business  
22 activities unrelated to operations of the current subsidiaries.

- 23 i. Copies of all relevant documents and filings with the United States Securities and  
24 Exchange Commission and other federal or state agencies.

25 The Applicants have made various filings for State and Federal approvals as  
26 required to consummate PAETEC's acquisition of McLeodUSA Parent.  
27 Copies of the documents have been provided to Staff in electronic format.  
28 Documents included filings made with the U.S. Securities and Exchange

Commission, Federal Communications Commission, and many States, such as California, Colorado, Georgia, Mississippi, New York, Pennsylvania, Tennessee, Texas, Delaware, Indiana, Louisiana, Minnesota, Ohio, West Virginia, and the District of Columbia.

- j. The contemplated annual and cumulative investment in each affiliate for the next five years, in dollars and as a percentage of projected net utility plant, and an explanation of the reasons supporting the level of investment and the reasons this level will not increase the risks of investment in the public utility.

PAETEC has indicated that its primary business is providing medium-sized and large business and enterprise organizations in large metropolitan areas with a package of integrated communications services, including local and long distance voice, data, and Internet services. PAETEC's services are currently provided by 12 wholly-owned subsidiaries which, collectively, operate in 48 States and the District of Columbia. To date, PAETEC has not contemplated the annual and cumulative investment in each of these affiliates for the next five years and, therefore, cannot provide the figures requested. However, PAETEC was able to provide confidential two year high level projected capital expenditures for the post-merger combined entity.

- k. An explanation of the manner in which the utility can assure that adequate capital will be available for the construction of necessary new utility plant and for improvements in existing utility plant at no greater cost than if the utility or its affiliate did not organize or reorganize a public utility holding company.

The Applicants represent that the Arizona operating subsidiaries of PAETEC and McLeodUSA Parent will be able to attract capital on terms no less favorable than prior to the merger. Adequate, and probably increased, capital will be available for growth and development in Arizona.

1           26.     The Parties have stated in its Application that McLeodUSA's Arizona customers  
2 will continue to receive service under the same rates, terms, and conditions of service as currently  
3 provided. The proposed merger is not expected to impair the financial status of the Arizona  
4 operating subsidiaries of PAETEC or McLeodUSA Parent; neither preventing them from attracting  
5 capital at fair and reasonable terms, or impairing the ability to provide safe, reasonable, and  
6 adequate service. Based on the information provided, Staff believes the Parties have complied  
7 with the requirements of A.A.C. R14-2-803(C) and 804(C).

8           27.     McLeodUSA requests authorization to pledge its Arizona assets as security for the  
9 debt issuance. A.R.S. §40-285 requires public service corporations to obtain Commission  
10 authorization to encumber certain utility assets. The statute serves to protect captive customers  
11 from a utility's act to dispose of any of its assets that are necessary for the provision of service,  
12 thus, it serves to preempt any service impairment due to disposal of assets essential for providing  
13 service. In this instance, a pledge of McLeodUSA's assets should not impair the availability of  
14 service to customers since McLeodUSA provides competitive services that are available from  
15 alternate service providers. However, customers may still have exposure to losses to the extent  
16 they have prepaid for service or made deposits. Accordingly, Staff finds that any authorization for  
17 encumbrances should provide customer protection for prepayments and deposits.

18 THE PUBLIC INTEREST

19           28.     McLeodUSA is in compliance with Decision No. 69346 in which the Commission  
20 approved an encumbrance of McLeodUSA's assets and a guaranty for certain financing  
21 arrangements of its parent.

22           29.     On February 20, 2007, in Decision No. 69346, the Commission approved  
23 McLeodUSA's pledge of its Arizona assets as security and for McLeodUSA to act as a co-  
24 guarantor for Senior Second Secured Notes issued by McLeodUSA Parent, and to participate in  
25 certain other financing arrangements. This proposed transaction will affect Decision No. 69346  
26 since McLeodUSA will participate in the replacement of the 2006/2007 debt, used to issue the  
27 Senior Second Secured Notes, with a new financing arrangement, however, McLeodUSA's assets  
28



1 will again be encumbered as security for the loans necessary to refinance the existing debt and  
2 purchase in this proposed Application.

3 30. As of November 1, 2007, the combined PAETEC and McLeodUSA companies'  
4 Arizona workforce consisted of approximately 18 employees. PAETEC has indicated that it does  
5 not foresee any Arizona workforce reductions or Arizona plant or facility closings from  
6 McLeodUSA, PAETEC, or any of its Arizona affiliates should this Application be approved by the  
7 Commission.

8 31. The proposed acquisition will allow PAETEC to add network assets including  
9 17,000 fiber-route miles and increase its total number of switches to 116. The combined company  
10 will benefit business customers by allowing it to offer a comprehensive suite of business services,  
11 and an extensive switching and fiber network. The transaction is also expected to strengthen the  
12 ability of the operating subsidiaries, including McLeodUSA and PCI, by allowing them to enhance  
13 their service offerings to Arizona consumers and provide more advanced telecommunications to a  
14 broader customer base. The combined managerial and operational expertise of both PAETEC and  
15 McLeodUSA Parent will also benefit the operating subsidiaries.

16 32. In its Application, the Parties have indicated that through the complementary  
17 strengths, product sets, and geographic footprints of the two companies, PAETEC should realize  
18 substantial cost savings and achieve \$30 million in cumulative cost synergies during the first and  
19 second years following closing of the transaction. PAETEC provided additional information  
20 indicating that the majority of synergy savings will be realized through the elimination of  
21 duplicative spending on network facilities. PAETEC expects to streamline its network through  
22 additional volume discounts on long distance and local wholesale services, consolidation of  
23 signaling networks, and consolidation of duplicative switching and collocation centers. Due to  
24 increased volume commitments through mergers and acquisitions, PAETEC anticipates lower per  
25 unit costs from its wholesale vendors, such as Qwest, Global Crossing, and AT&T, who build their  
26 networks that support toll free services which PAETEC offers to its business customers. The  
27 lower per unit costs will allow PAETEC to more competitively price the service to its retail  
28 customer base, including its customers in Arizona.

1        33.     The Applicants have indicated that McLeodUSA has invested \$40.52 million in  
2 telecommunications equipment in Arizona, primarily consisting of one Class 5 switch, one soft  
3 switch, 28 collocations, and a limited amount of intercity fiber. PAETEC, currently, has no  
4 physical presence in Arizona and, therefore, the value of its investment in Arizona is zero.  
5 PAETEC provided Staff with confidential high level projected capital expenditures for 2008 and  
6 2009 for the post-merger combined entity.

7        34.     In Decision No. 69346, the Commission approved McLeodUSA's request for  
8 authorization to issue guarantees and pledge its Arizona assets as security for certain financing  
9 arrangements of its parent McLeodUSA Parent. In a private offering on September 28, 2006,  
10 McLeodUSA Parent issued approximately \$120 million in 10½ percent Senior Secured Notes due  
11 in 2011. As part of the financing arrangement, McLeodUSA Parent agreed to exchange the Senior  
12 Secured Notes for substantially identical notes, registered under the Federal Securities Laws,  
13 within 180 days. Subject to certain conditions, McLeodUSA Parent and its subsidiaries were  
14 allowed to incur additional debt and grant additional liens on their assets, including incurring new  
15 debt up to \$26 million in aggregate principal amount.

16        35.     McLeodUSA now seeks the authorization to guarantee the obligations of PAETEC,  
17 as borrower, under Senior Secured Credit Facilities of \$550 million aggregate principal amount;  
18 grant a security interest in all of its assets to secure all amounts owing under the Credit Facilities;  
19 guarantee the obligations of PAETEC under the \$300 million aggregate principal amount of  
20 PAETEC's 9.5% Senior Notes due 2015; and incur, guarantee, and/or secure additional  
21 borrowings of up to \$500 million of additional indebtedness in the form of incremental term loans  
22 and additional notes. This new encumbrance of McLeodUSA's assets and related guaranty will  
23 replace McLeodUSA's existing encumbrance and guaranty approved by the Commission in  
24 Decision No. 69346.

25        36.     The Applicants have indicated that McLeodUSA's existing \$600,000 performance  
26 bond, which was obtained as a requirement of Decision No. 64657, granted March 25, 2002, will  
27 continue to remain in place. McLeodUSA currently holds deposits from Arizona customers  
28 totaling \$7,346.86. No customer deposits are being held in Arizona by any other affiliates of

1 McLeodUSA Parent. PAETEC and its affiliates are not holding any deposits from Arizona  
2 customers. PAETEC has indicated that it is of the understanding that McLeodUSA's \$600,000  
3 performance bond, currently in place, cannot be used in the encumbrance of assets.

4 37. In the Application, PAETEC will acquire McLeodUSA Parent in an all-stock  
5 merger for approximately \$557 million. The merger price consists of approximately \$492 million  
6 in PAETEC common stock and approximately \$65 million in net debt assumption. Current  
7 McLeodUSA Parent shareholders will receive 1.30 shares of PAETEC common stock for every  
8 share of McLeodUSA Parent common stock that they own.<sup>4</sup> As indicated previously, the proposed  
9 transaction will have no impact on the rates, terms and conditions of service currently provided to  
10 customers of McLeodUSA. As supported by the information previously provided, Staff believes  
11 that the proposed transaction will not impair the financial status of the Arizona operating  
12 subsidiaries of PAETEC or McLeodUSA Parent; nor prevent the Applicants' ability to attract  
13 capital at fair and reasonable terms and to provide safe, reasonable, and adequate service.

14 38. Pursuant to A.A.C. R14-2-805, McLeodUSA is up to date with filing its 2006  
15 annual diversification activities and plans. PAETEC and its Arizona affiliates combined Arizona  
16 annual operating revenues do not exceed \$1 million; therefore PAETEC is not subject to A.C.C.  
17 R14-2-805. The Compliance Division has stated that there are no delinquencies for PAETEC and  
18 McLeodUSA. Staff has verified that the 2006 annual reports of McLeodUSA and PAETEC and  
19 its Arizona subsidiaries are on file with the Commission and up to date. On December 4, 2007, the  
20 Corporations Division reports that McLeodUSA and the other 3 Arizona affiliates of McLeodUSA  
21 Parent are in good standing. In addition, the 2 Arizona subsidiaries of PAETEC are also in good  
22 standing.

23 39. Both PAETEC and McLeodUSA have indicated that there are no outstanding or  
24 unresolved consumer complaints pending with this Commission. Staff's search of the Consumer  
25 Services database for the past 3 years through December 4, 2007 for McLeodUSA, indicates a  
26

27 <sup>4</sup> It is noted in the Application, that approximately 40 million shares of PAETEC common stock will be issued to  
28 shareholders of currently outstanding McLeodUSA Parent stock. PAETEC has approximately 102.1 million shares of  
common stock currently outstanding. McLeodUSA Parent's employee stock options, of which 2.7 million are  
outstanding, will be converted into options to purchase PAETEC shares, to the extent not exercised before closing.

1 total of 20 complaints, 6 inquiries, and 1 opinion, and that all complaints have been resolved and  
2 closed. During that same time period, no complaints, inquiries, or opinions have been filed on the  
3 other McLeod Parent Arizona affiliates or PAETEC Arizona subsidiaries.

4 40. On December 12, 2007, the Applicants submitted an Affidavit of Publication  
5 confirming publication of a legal notice relative to the proposed transaction in *The Arizona*  
6 *Republic* on December 10, 2007. The Applicants have also provided Staff with a draft of a direct  
7 mailing that will be provided to the McLeodUSA customers following a decision in this matter.  
8 Staff has reviewed the proposed customer notice and concludes that it is consistent with  
9 Commission requirements.

10 41. Staff is not aware of any concerns or objections filed by any entity or individual.  
11 Staff reviewed the Application and supplemental filings; and considered all responses to Staff's  
12 data requests.

13 STAFF'S RECOMMENDATIONS

14 42. Staff recommends that the Application of PAETEC and McLeodUSA Parent for a  
15 transfer of control of McLeodUSA to PAETEC, resulting from the proposed merger, be approved  
16 pursuant to A.A.C. R14-2-803.

17 43. Staff recommends that the Application of PAETEC and McLeodUSA Parent for  
18 McLeodUSA's participation in debt financing arrangements be approved pursuant to A.R.S. 40-  
19 285 and A.A.C. R14-2-804.

20 44. Staff also recommends that the Application be approved without a hearing because  
21 Staff believes this transaction does not:

- 22 a. impair the financial status of the Applicants;
- 23 b. prevent the Applicants' ability to attract capital at fair and reasonable terms;
- 24 c. prevent the Applicants' ability to provide safe, reasonable and adequate  
25 service;
- 26 d. adversely affect customers.

27 45. Staff further recommends that approval be conditioned on the following:

- 28 a. That PAETEC provides notice to the Commission within 30 days following  
the acquisition close proposed in this transaction.

- 1           b.    That for one year following acquisition close or until PAETEC and  
2           McLeodUSA Parent informs the Commission by filing an affidavit with  
3           Docket Control that acquisition-related activities are completed, whichever  
4           occurs last, PAETEC and McLeodUSA Parent provide written notification  
5           to the Director of the Utilities Division and to the individual members of the  
6           Commission, at least 60 days in advance, of any planned acquisition-related  
7           Arizona workforce layoffs; any planned acquisition-related Arizona plant  
8           closings; and any planned acquisition-related Arizona facility closings.
- 9           c.    That McLeodUSA Parent and PAETEC provide the Compliance Section  
10          with updates by April 15, 2008 and April 15, 2009 on the status of plans to  
11          increase employees and investment in Arizona.
- 12          d.    That McLeodUSA Parent and PAETEC provide the Compliance Section  
13          with updates by April 15, 2008 and April 15, 2009 of any changes in the  
14          status of debt financing plans.
- 15          e.    That PAETEC be limited from pledging any customer deposits, advances, or  
16          prepayments currently held by McLeodUSA or which may be held by  
17          McLeodUSA and/or PAETEC in the future, as debt security.
- 18          f.    That PAETEC shall file, as an annual compliance item in this docket, a  
19          notarized attestation from an Officer stating whether all Arizona customer  
20          deposits, advances, and prepayments are excluded from encumbrance, or  
21          whether they are secured by a performance bond or irrevocable sight draft  
22          Letter of Credit which is not included in the pledged collateral.
- 23          g.    That PAETEC notifies the McLeodUSA customers of the acquisition  
24          through a direct mailing to the McLeodUSA customers. Verification of the  
25          notice should be filed with Docket Control within 90 days of a decision in  
26          this matter.

#### CONCLUSIONS OF LAW

- 25          1.    PAETEC, McLeodUSA Parent, and McLeodUSA are public service corporations  
26          within the meaning of Article XV of the Arizona Constitution.
- 27          2.    The Commission has jurisdiction over McLeodUSA and the subject matter in this  
28          filing.

## ORDER

IT IS FURTHER ORDERED that PAETEC and McLeodUSA Parent provide the Compliance Section with updates by April 15, 2008 and April 15, 2009 on the status of plans to increase employees and investment in Arizona.

1 IT IS FURTHER ORDERED that PAETEC and McLeodUSA Parent provide the  
2 Compliance Section with updates by April 15, 2008 and April 15, 2009 of any changes in the  
3 status of debt financing plans.

4 IT IS FURTHER ORDERED that PAETEC, McLeodUSA Parent, and McLeodUSA be  
5 limited from pledging any customer deposits, advances, or prepayments currently held by  
6 McLeodUSA or which may be held by McLeodUSA and/or PAETEC in the future, as debt  
7 security.

8 IT IS FURTHER ORDERED that PAETEC shall file, as an annual compliance item in this  
9 docket, a notarized attestation from an Officer of the Company stating whether all Arizona  
10 customer deposits, advances, and prepayments are excluded from encumbrance, or whether they  
11 are secured by a performance bond or irrevocable sight draft Letter of Credit which is not included  
12 in the pledged collateral.

13 IT IS FURTHER ORDERED that PAETEC completes the recommended notice to the  
14 McLeodUSA customers of the proposed acquisition and financing through a direct mailing to the  
15 McLeodUSA customers.

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1 IT IS FURTHER ORDERED that PAETEC file verification that the notice has been  
2 completed with Docket Control within 90 days of a decision in this matter.

3 IT IS FURTHER ORDERED that this Decision shall become effective immediately.

4  
5 **BY THE ORDER OF THE ARIZONA CORPORATION COMMISSION**

6  
7   
8 CHAIRMAN


  
COMMISSIONER

9  
10  
11 COMMISSIONER

  
COMMISSIONER

  
COMMISSIONER

12 IN WITNESS WHEREOF, I DEAN S. MILLER, Interim  
13 Executive Director of the Arizona Corporation Commission,  
14 have hereunto, set my hand and caused the official seal of  
15 this Commission to be affixed at the Capitol, in the City of  
16 Phoenix, this 23<sup>rd</sup> day of January, 2008.

17  
18   
19 DEAN S. MILLER  
Interim Executive Director

20 DISSENT: \_\_\_\_\_

21  
22 DISSENT: \_\_\_\_\_

23 EGJ:PJG:tdp/MAS  
24  
25  
26  
27  
28



1 SERVICE LIST FOR: PAETEC Holding Corp., McLeodUSA Inc., and McLeodUSA  
2 Telecommunications, Services, Inc.

3 DOCKET NO. T-03267A-07-0554

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Ms. Lyn Farmer  
Chief Administrative Law Judge, Hearing Division  
Arizona Corporation Commission  
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# EXHIBIT

"A"